



‘Caving’ Carefully: Some Lease Concessions Shouldn’t Be Made

By Steven P. Heller, Esq.

Sometimes a landlord—desperate to land a tenant—dispenses with his or her usual careful lease review. The sentiment is usually something like, “Just confirm the dollars and dates and get it signed up!” But no matter how much leverage a tenant has, the landlord must address potential land mines in the lease document.

Tenants have the advantage in a soft leasing market or when landlords face economic duress or other property-specific demands like co-tenancy. In these circumstances, a landlord may have only enough leverage to negotiate the most basic business issues while conceding to the tenant nearly everything else in the lease document.

Making matters worse, pressured landlords may feel that addressing so-called “legal” issues (i.e., lease provisions other than basic economic terms) or even using an attorney at all is a luxury they can’t afford.

But some lease concessions have deep implications, and landlords need to understand clearly the stakes before caving in categorically. The following briefly surfaces only some of these common “buried” lease issues. A landlord planning to give away these issues should at least carefully consider what’s at stake before caving in.

First, keep initial landlord commitments realistic. Trying to land a tenant with great leverage often requires making great

promises to the tenant. But agreeing to do the undoable is the road to a landlord default. Sharpen vague provisions for constructing and delivering space to the tenant because the burden will be on the landlord to clearly show he or she met all rent-start conditions. Spell out construction specifications and milestone dates (don’t assume the lease has “*force majeure*” or “tenant delay” protections).

Some tenants overreach on “green” construction goals. Don’t let a tenant’s desire for environmentally sustainable space trigger a commitment to unrealistically ambitious green building standards; landlords cannot guaranty “LEED Gold” or similar certifications, but they can agree to try to obtain certain standards, subject to a cost cap.

Second, protect the ownership from liability. As important as a particular lease deal may be, the document must include fundamental insurance, indemnity and limited liability provisions. Some tenants propose clearly inadequate coverage limits; I’ve seen major tenant lease forms with no provisions for tenant insurance or tenant indemnity. Have an attorney or insurance consultant look closely at the coverage the tenant will maintain before disregarding insurance provisions as unimportant in the heat of a desperate lease negotiation.

Beyond insurance, limit landlords’ overall liability. Landlord-oriented leases limit recourse against the owner (typically based

on the owner’s interest in the project) and bar personal recourse against investors, employees, etc. But tenants with leverage may resist these limits, and tenant lease forms often omit them entirely. Maintain limits adequate for the ownership (if the landlord is a single-asset entity, this issue may be less critical).

Third, avoid provisions that require landlords to provide something out of their control. For example, leverage tenants expect the landlord’s lender to provide a nondisturbance agreement (“NDA” or “SNDA”). But committing to the tenant’s preferred SNDA form may stick the landlord in the middle—what if the lender doesn’t like that form? Get the lender and the tenant to agree in advance on a form; otherwise, promise only “reasonable efforts to try” to obtain the tenant’s form of SNDA.

Landlords also cannot control other parties to recorded agreements (e.g., CC&Rs or REAs). The landlord can’t guaranty something for the tenant if it conflicts with recorded agreements, such as parking rights that require an adjoining owner’s approval.

Continued on back.



Steven P. Heller is a partner at Gilchrist & Rutter in Santa Monica, Calif. His practice focuses on commercial real estate and business transactions.

'Caving' Carefully *continued*

Other parties that can elude landlords' control are tenant assignees and subtenants. Leverage tenants naturally seek maximum flexibility with regard to potential exit strategies, including wide-open transfer provisions; if the tenant won't allow the landlord meaningful approval rights or even recapture rights, at least require the tenant to give advance notice of a transfer.

Fourth, beware of excessive tenant termination rights for minor breaches. Termination might not be a worry amid the optimism of a new lease but may concern lenders. If you can't delete them, modify these provisions to at least require the tenant to give the landlord (and his or her lender) written notice and a chance to address the problem before the tenant can terminate.

Fifth, minimize the potential for use clauses to create chaos. As appealing as a prized tenant may seem initially, poorly drafted use provisions open the door to future use changes that threaten the project's stability. To preserve maximum flexibility, major tenants avoid language limiting their use. But a weak use clause can lead to problems—a tenant in a Class A office building may

start a call center, tripling its employees; stakes are higher in a retail context. A landlord unable to negotiate a strong use clause should at least require the tenant to comply with laws, any CC&Rs and other property-specific standards, and should prohibit office tenants from uses "substantially increasing the burden on common building services or capacities." In the retail context, review existing leases' co-tenancy clauses, and rein in the tenant's overly liberal "go dark" or use-change clauses. Don't forget assignment provisions, which may quietly provide a loophole allowing use changes.

Overly broad exclusive use rights make it harder to market a project to future tenants. To reduce competition, anxious retailers want exclusives preventing other tenants from selling specified products or services; a landlord eager to land a major retailer might agree to an expansive exclusive.

But resist exclusivity language so vague that future leasing prospects won't know if their products are permitted; one home retailer demands an amorphous exclusive for "giftware"—future prospects might avoid leasing at a center if they fear their products might be "gifts."

Also, always exempt existing tenants (and their assignees) and potential anchor tenants from exclusive rights.

Sixth, watch for mounting costs from special tenant privileges regarding project operations. Minor privileges can add up and even disturb standard operations of building structures and systems. Consider the aggregate cost of free HVAC, frequent repainting/recarpeting, special parking deals and unregulated cabling rights without any removal obligation. Expansive self-help maintenance rights should also concern landlords if they're written so broadly that the tenant can access building systems usually left to building engineers. Giving prospective tenants special concessions incentivizes them to sign the lease—but at what cost?

To secure a tenant with great leverage, a landlord has to make concessions and sometimes even submit to nearly all of a tenant's preferred lease provisions. With limited ammunition for negotiating against such a tenant, landlords who recognize potential land mines in lease documents will know where to concentrate their efforts.

This article was originally published in the December 14, 2009 issue of the California Real Estate Journal. © 2009 The Daily Journal Corporation. All rights reserved.